Health and
Human Services

Pat McCrory
Governor

Richard O. Brajer
Secretary

October 1, 2016

SENT VIA ELECTRONIC MAIL

The Honorable Louis Pate, Co-Chair
Joint Legislative Oversight Committee on
Health and Human Services
North Carolina General Assembly
Room 1028, Legislative Office Building
Raleigh, NC 27601-2808

The Honorable Josh Dobson, Co-Chair
Joint Legislative Oversight Committee on
Health and Human Services
North Carolina General Assembly
Room 301N, Legislative Office Building
Raleigh, NC 27603-5925

The Honorable Marilyn Avila, Co-Chair
Joint Legislative Oversight Committee on
Health and Human Services
North Carolina General Assembly
Room 2217, Legislative Building
Raleigh, NC 27601

Dear Chairmen:

Session Law 2015-241, Section 31.10.(a) requires the Department of Health and Human Services to report on the plan to relocate all administrative personnel and resources of the Department located on the Dorothea Dix Campus and on other property leased or owned by the State in the Greater Triangle area. The Department shall report the plan to the Joint Legislative Oversight Committee on Health and Human Services and the Fiscal Research Division by October 1, 2016. The plan required by this section shall include the location to which the personnel and resources of the Department of Health and Human Services will be relocated, the square footage needed in order to accommodate the relocation, a statement of anticipated costs or benefits associated with the relocation, a schedule for implementation of the relocation plan, identification of any potential obstacles to the plan, and options for financing the relocation plan developed in conjunction with the State Treasurer and the State Controller. Pursuant to the provisions of law, the Department is pleased to provide the attached report.

Health and
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Please direct any questions regarding this report to Luke Hoff, Director of Property and Construction, at 919-855-4870, or Luke.Hoff@dhhs.nc.gov.

Sincerely,

Richard O. Brajer
Secretary

cc:	Pam Kilpatrick	Brian Perkins	Theresa Matula	Rod Davis
	Joyce Jones	Kolt Ulm	Hannah Tedder	Andy Munn
	reports@ncleg.net	Susan Jacobs	Marjorie Donaldson	Luke Hoff

Health and
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SENT VIA ELECTRONIC MAIL

Mr. Mark Trogdon, Director
Fiscal Research Division
Suite 619, Legislative Office Building
Raleigh, NC 27603-5925

Dear Director Trogdon:

Session Law 2015-241, Section 31.10.(a) requires the Department of Health and Human Services to report on the plan to relocate all administrative personnel and resources of the Department located on the Dorothea Dix Campus and on other property leased or owned by the State in the Greater Triangle area. The Department shall report the plan to the Joint Legislative Oversight Committee on Health and Human Services and the Fiscal Research Division by October 1, 2016. The plan required by this section shall include the location to which the personnel and resources of the Department of Health and Human Services will be relocated, the square footage needed in order to accommodate the relocation, a statement of anticipated costs or benefits associated with the relocation, a schedule for implementation of the relocation plan, identification of any potential obstacles to the plan, and options for financing the relocation plan developed in conjunction with the State Treasurer and the State Controller. Pursuant to the provisions of law, the Department is pleased to provide the attached report.

Please direct any questions regarding this report to Luke Hoff, Director of Property and Construction, at 919-855-4870, or Luke.Hoff@dhhs.nc.gov.

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	Joyce Jones	Kolt Ulm	Hannah Tedder	Andy Munn
	reports@ncleg.net	Susan Jacobs	Marjorie Donaldson	Luke Hoff

Plan for Relocating all DHHS Offices to One Location

Session Law 2015-241, Section 31.10.(a)

Report to

The Joint Legislative Oversight Committee on

Health and Human Services

and

The Fiscal Research Division

By

North Carolina
Department of Health and Human Services

October 1, 2016

EXECUTIVE SUMMARY

Session Law 2015-241 (31.10)(a) states that the Department of Health and Human Services (DHHS) in consultation with the Department of Administration (DOA) shall develop a plan for relocating all DHHS administration personnel and resources on the Dorothea Dix Campus and in other property leased or owned by the State in the Greater Triangle Area to one site available to the State. DHHS is to report the relocation plan to the Joint Legislative Oversight Committee and the Fiscal Research Division by October 1, 2016.

This will be a very large project involving the construction of approximately one million square feet of building space and parking decks, and the relocation of approximately 4,300 employees.

Location

Based on an evaluation of 10 different sites, the approximately 40-acre Gold Star Drive site in Raleigh is recommended as the best site for the New DHHS Business Complex. This state-owned property is located in Raleigh along Gold Star Drive between Wade Avenue and Reedy Creek Road. DHHS and DOA are recommending this site for the New DHHS Business Complex because it is adjacent to the existing State Lab and Office of the Chief Medical Examiner facility, easily accessible to the public, centrally located to the homes of DHHS employees who will be commuting to the new complex, and it is relatively close to other State agencies located in downtown Raleigh.

Financing

Three different project delivery methods were considered for the new complex located on the Gold Star Drive site:

1. Build-to-Own,
2. Lease-to-Own; and,
3. Straight-Lease.

Financing options for the Build-to-Own method included State financed General Obligation Bonds and Special Indebtedness at an interest rate of 5.75% and 6.00%, respectively. Developer financing with an assumed 6.50% interest rate was used for the Lease-to-Own and Straight-Lease methods. All financing terms for the Build-to-Own and Lease-to-Own methods of delivery were assumed to be 20-year terms, and a 30-year term was assumed for the Straight-Lease method.

Build-to-Own and Lease-to-Own options need to accommodate 4,366 employees which requires 972,182 Gross Square Feet (GSF) of office space and 95,139 GSF of warehouse and maintenance space for a total of 1,067,321 GSF of space and 4,922 parking spaces for employees and visitors. For both the Build-to-Own and Lease-to-Own options, the annual operating cost for the new complex was estimated at $8,871,626 and the annual budget to account for anticipated replacement of building materials and major equipment over the useful life of the complex was estimated at $1,068,771.

The owner of leased property is typically responsible for providing all maintenance services. Therefore, the Straight-Lease option does not include 68 DHHS maintenance employees and a 17,588 GSF maintenance building and has 68 fewer parking spaces. The Straight-Lease option needs to accommodate 4,298 employees which requires 904,129 Useable Square Feet (USF) of office space and

76,000 USF of warehouse space for a total of 980,219 USF of space and 4,854 parking spaces for employees and visitors.

The initial total estimated project cost of the New DHHS Business Complex on the Gold Star Drive site utilizing the Build-to-Own or Lease-to-Own project delivery method is $554,413,000. Assuming an occupancy term of 30 years, the 30-Year Residual Value of the New DHHS Business Complex for the Build-to-Own and Lease-to-Own methods of delivery is $129,735,000.

Lease rates used for the Straight-Lease method of delivery include maintenance, utilities, janitorial, grounds, furniture costs, and parking. The rates also account for the increased costs of high rise office space and parking deck construction required for the preferred Gold Star Drive site. It is anticipated that the first lease payment will be made in 2023 to account for the time required for obtaining State funding approval, issuing an RFP to developers, and for the successful developer designing and constructing the new business complex. Therefore, the first year (2023) lease rates were estimated by escalating 2016 lease rates of comparable leased properties over a seven-year period using a 3% lease rate growth factor. For building the new DHHS business complex on the Gold Star Drive site, the initial lease rates for year 2023 were taken as $38.00/USF for high rise office space and parking deck construction and $17.00/USF for warehouse space. A 3% annual lease growth rate was applied to all lease rates for the term of the lease. The estimated total first year lease cost to the State for the Straight-Lease method of delivery is $35,648,902. The Straight-Lease project delivery method involves no State ownership of the project and no Residual Value at the conclusion of the lease.

Considering a 30-year occupancy period, the table below summarizes the net costs and Net Present Value (NPV) for providing the New DHHS Business Complex on the Gold Star Drive site for different financing options including General Obligation Bonds (GOB) and Special Indebtedness (SI) financing:

30-YEAR COSTS SUMMARY FOR NEW DHHS BUSINESS COMPLEX LOCATED AT GOLD STAR DRIVE SITE				
Project Delivery Method	**Build-to-Own**	**Build-to-Own**	**Lease-to-Own**	**Straight-Lease**
Financing	**State Financed GOB 20 Yr @ 5.75%**	**State Financed SI 20 Yr @ 6.0%**	**Developer Financed 20 Yr @ 6.5%**	**Developer Financed 30 Yr @ 6.5%**
Site Location	**Gold Star Dive**	**Gold Star Dive**	**Gold Star Dive**	**Gold Star Dive**
Net Expense	$ 806,471,540	$ 853,285,970	$ 923,655,088	$ 1,191,589,775
30-Year NPV	**$ 571,760,751**	**$ 606,774,015**	**$ 658,932,988**	**$ 688,973,236**

The estimated one-time moving cost to relocate DHHS employees to the New DHHS Business Complex is $2,500,000.

<u>Benefits</u>

Relocating DHHS employees to a new DHHS office complex will provide the benefit of designing the new complex based on current design concepts which focus on creating flexible open and flowing work areas and meeting spaces that invite workers to move around freely and mix with each other resulting in greater communication, collaboration, innovation, effectiveness, and efficiencies. Additional benefits include less travel time and costs, improved productivity, reduced energy consumption, more efficient maintenance operations, and improved efficiencies in telephone and data systems operations.

<u>Schedule</u>

The overall schedule for implementation of the relocation plan is shown below.

State Budget Approval	July, 2017
Design Starts	January, 2018
Construction Starts	January, 2020
Construction Complete	January, 2023
Move-In Complete	January, 2024

Potential obstacles to the relocation plan include funding approval, the need to reallocate the selected site from DEQ to DHHS, and potential design, bidding, and construction issues.

BACKGROUND

The State of North Carolina and City of Raleigh executed the contract for the sale of the 308-acre Dorothea Dix Campus from the State to the City on July 24, 2015. The contract specified that the North Carolina DHHS would lease back from the City certain portions of the east and west areas of the campus for 10 and 25 years, respectively. This resulted in the need for the State to develop a plan to relocate DHHS off the campus and to a new location prior to the expiration of the lease-back agreements. DHHS recognized this as an opportunity to improve operational efficiencies and departmental communications by consolidating all DHHS administrative staff members (and not service provider staff members) working on the Dorothea Dix Campus and in property leased and owned by the State in the Greater Triangle area (consisting of Durham, Orange, Johnston, and Wake Counties) to one new business complex location. Session Law 2015-241 (31.10)(a) states that DHHS shall develop (in consultation with DOA) and report a relocation plan to the Joint Legislative Oversight Committee and the Fiscal Research Division by October 1, 2016. Session Law 2015-241 (31.10)(a) also states that the relocation plan shall include at least the following information:

(1) The location to which the personnel and resources of the Department of Health and Human Services will be relocated.
(2) The square footage needed in order to accommodate the relocation.
(3) A statement of anticipated costs or benefits associated with the relocation.
(4) A schedule for implementation of the relocation plan.
(5) Identification of any potential obstacles to the relocation plan.
(6) Options for financing the relocation plan developed in conjunction with the State Treasurer and the State Controller.

PROJECT DELIVERY METHOD OPTIONS

The following project delivery method options were considered for evaluating project costs for the New DHHS Business Complex being located on the recommended Gold Star Drive site: Build-to-Own, Lease-to-Own, and Straight Lease.

The Build-to-Own method of delivery would entail a traditional design/bid/build approach coupled with either a single prime or construction manager at risk means of construction. The State would follow State policies and procedures for advertising, selecting, and contracting directly with a designer for providing design, bidding, and construction administration services and for contracting with a contractor for providing construction services. The State would also be responsible for all operating costs including maintenance and utility costs throughout the life of the new business complex. Maintenance services will be provided by State employees and will require maintenance facilities as part of the new business complex.

The Lease-to-Own method of delivery would involve the State developing a Request for Proposal (RFP) for soliciting proposals from interested developers. The RFP would contain written specifications regarding the requirements of the project including DHHS space requirements. The State would select and contract with the successful developer. Assuming two years for design, three years for construction, and a DHHS 20-year occupancy period in the new business complex, the State will provide the developer a 25-year land lease for the State-owned land located at the Gold Star Drive site. The developer would be responsible for selecting his design and construction team and for contracting directly with a designer for providing design services and with a contractor for providing construction services. The developer would be responsible for funding all initial project costs. The developer would provide the State with a lease payment schedule such that the State would own the buildings after 20 years of lease payments. Upon occupying the new complex, the State would be responsible for all operating costs including maintenance and utility costs throughout the life of the new business complex. Maintenance services will be provided by State employees and will require maintenance facilities as part of the new business complex.

The Straight-Lease method of delivery would involve the State developing an RFP for soliciting proposals from interested developers. The RFP would contain written specifications regarding the project requirements, including DHHS space requirements. The State would select and contract with the successful developer. The State would provide the developer a long-term (assumed 99-year) land lease for the State-owned land located at the Gold Star Drive site. The developer would be responsible for selecting his design and construction team and for contracting directly with a designer for providing design services and with a contractor for providing construction services. The developer would be responsible for funding all initial project costs. The developer would also be responsible for all operating costs including maintenance services and utility costs throughout the life of the new business complex. The developer would determine a lease rate schedule that would be paid by the State starting once DHHS occupies the new complex and that would continue to be paid by the State for the term of lease agreement.

(1) The location to which the personnel and resources of the Department of Health and Human Services will be relocated.

Nine State-owned sites and one Town of Garner owned site were considered for the New DHHS Business Complex. Suitability of each site included availability of the site, public access to the site, DHHS employee access to the site, proximity of the site to other State agencies in downtown Raleigh, and existing site conditions impacting project costs. By using the zip codes of homes of DHHS employees who will be commuting to the new DHHS business complex, the central point of all the DHHS employees was calculated to be near the Legislative Office Building located in downtown Raleigh. Therefore, to minimize the negative impact to DHHS employees who will be commuting to the new complex, the business complex should be located as close as possible to the Legislative Office Building. Ideally, an 80- to 100-acre site would minimize project costs by allowing for all low-rise and no high-rise office building construction and for 100% surface parking and no parking decks. Based on the evaluation of the 10 different sites listed below, the Gold Star Drive site in Raleigh is recommended as the best site for the New DHHS Business Complex.

1. Gold Star Drive Site: State-owned, roughly 40-acre site. Located along Gold Star Drive between Wade Avenue and Reedy Creek Road and adjacent to the existing State Lab and Office of the Chief Medical Examiner facility. Allocated to the NC Department of Environmental Quality.
   Status: Recommended site. DHHS recommends the Gold Star Drive Site for the New DHHS Business Complex considering that it is adjacent to the existing State Lab and Office of the Chief Medical Examiner facility, easily accessible to the public, centrally located to the homes of DHHS employees who will be commuting to the new complex, and it is relatively close to other State agencies located in downtown Raleigh. Although the size of the site will require high rise office construction and 2/3 parking deck and 1/3 surface parking, the benefits of the location of the site outweigh the construction cost premium for high rise and parking deck construction.

2. Edwards Mill Road Site: State-owned, approximately 111-acre site. Located along Edwards Mill Road and between Wade Avenue and Reedy Creek Road. Allocated to North Carolina State University (NCSU) and the NC Department of Agriculture.
   Status: Not available. NCSU and NC Department of Agriculture need to retain this property to meet planned critical operational needs.

3. Reedy Creek Road Site: State-owned, roughly 150-acre site. Located along Reedy Creek Road at the intersection of Reedy Creek Road and Edwards Mill Road and across from Schenck Forest. Allocated to NCSU.
   Status: Not available. NCSU needs to retain this property to meet planned critical operational needs.

4. Tryon Road Site: State-owned, approximately 133-acre site. Located along Tryon Road, between Hammond Road and West Garner Road. Allocated to Department of Public Safety.
   Status: Not available. Relocating the existing State Highway Patrol training track and facilities would be disruptive to the operations of the State Highway Patrol and costly.

5. Cary Towne Boulevard Site: State-owned, about 96-acre site. Located along Cary Towne Boulevard between Interstate 40 and SE Maynard Road.
   Status: Not available. Offer accepted. Final sale is contingent on buyer receiving zoning approval from the Town of Cary.

6. Trenton Road Site: State-owned, roughly 85-acre site. Located along Trenton Road, between SAS Campus Drive and Chapel Hill Road. Allocated to NCSU.
   Status: Not available. Property deal between NCSU and SAS.

7. Poole Road Site: State-owned, about 72-acre site. Located along Poole Road, between Interstate 64 and Sunnybrook Road.
   Status: Not available. Allocated for new Division of Motor Vehicles building.

8. Blue Ridge Road Site: State-owned, approximately 40-acre site. Located along Blue Ridge Road, between Reedy Creek Road and District Drive. Allocated to DOA, Department of Transportation, and Department of Agriculture.
   Status: Not available. DOA to sell portion of site.

9. Mid Pines Road Site: State-owned, roughly 150-acre site. Located along Mid Pines Road, surrounded by Mid Pines Road, Tryon Road, and Lake Wheeler Road. Allocated to NCSU.
   Status: Not available. NCSU needs to retain this property to meet planned critical operational needs.

10. Garner ConAgra Site: Town of Garner-owned, approximately 99 total (76 buildable) acre site. Located along Jones Sausage Road, between Jones Sausage Road and Interstate 40 and north of East Garner Road.
    Status: Available. Less desirable property than the Gold Star Drive site considering the location, the extent of roadway improvements needed, and that the State does not own the site.

(2) The square footage needed in order to accommodate the relocation.

The New DHHS Business Complex will accommodate approximately 4,300 DHHS administrative employees with about half relocating from the Dorothea Dix Campus and the other half moving out of State-leased or State-owned property in the Greater Triangle area. Each DHHS division evaluated its current staffing needs including full-time, part-time, permanent, temporary, and contract workers, as well as, space needs including security, privacy, conference, and storage. A 5% growth factor was utilized to account for potential future growth. Office space requirements were developed using modern design concepts of providing more open office space to reduce the amount of building area and to provide more interactive and flexible space for the new business complex. Three different project delivery methods were considered: Build-to-Own and Lease-to-Own based on Gross Square Footage (GSF) and Straight-Lease based on Useable Square Footage (USF). GSF applies to the entire footprint of a building including tenant space, common space used by the public, stairwells, elevator shafts, duct shafts, vertical penetrations, and storage, mechanical, and equipment rooms. USF is the square footage that is used exclusively by the tenant and includes tenant-only used rest rooms, closets, storage and any

other areas used only by the tenant and does not include any other space. The calculated ratio of office USF/GSF is 0.93, and the calculated ratio of warehouse USF/GSF is 0.98. The Build-to-Own and Lease-to-Own options need to accommodate 4,366 employees which requires 972,182 GSF of office space and 95,139 GSF of warehouse and maintenance space for a total of 1,067,321 GSF of space and 4,922 parking spaces for employees and visitors. The owner of leased property is typically responsible for providing all maintenance services. Therefore, the Straight-Lease option does not include 68 DHHS maintenance employees and a 17,588 GSF maintenance building, and has 68 fewer parking spaces. The Straight-Lease option needs to accommodate 4,298 employees which requires 904,129 USF of office space and 76,000 USF of warehouse space for a total of 980,219 USF of space and 4,854 parking spaces for employees and visitors. All three considered project delivery methods will require new construction to meet the total square footage requirement and to meet the requirement of all space being at the same location. Actual final number, size, height, and layout of buildings and phasing plan for the project shall be determined during the design phase of the project.

(3) A statement of anticipated costs or benefits associated with the relocation.

Costs of Relocating

The Gold Star Drive approximately 40-acre site will require high rise office buildings, 2/3 parking deck construction, and 1/3 surface parking. The cost premium associated with high rise compared to low rise office space is approximately an 8% increase in construction costs. The cost of parking deck construction is about eight times more expensive than surface parking. Therefore, it is more cost effective to focus on minimizing the amount of required parking decks even if site conditions require high rise office space to do so. Although the size of the Gold Star Drive site will have a construction cost premium for high rise and parking deck construction, the benefits of the location of the site outweigh the construction cost premium. The current construction market has resulted in about a 25% increase in total project costs over the past 12 to 18 months due primarily to a shortage of qualified subcontractor labor forces. Construction costs used for both the Build-to-Own and Lease-to-Own methods of delivery have been adjusted to account for this recent increase in construction costs. For the Straight-Lease method of delivery, the developer will have to provide newly constructed lease space to meet the total square footage required for the New DHHS Business Complex and will incur the recent increase in construction costs. The developer’s lease rate to the State will reflect the increase in construction costs to build the new DHHS complex. Therefore, the recent increase in total project costs for commercial construction was a consideration when estimating the lease rates used for the Straight-Lease method of delivery.

The initial total estimated project cost was developed for the New DHHS Business Complex on the Gold Star Drive site assuming either a Build-to-Own or Lease-to-Own method of delivery. A term of 60 months was assumed from the date that the estimate was developed to the midpoint of the construction term, and a monthly construction escalation rate of 0.42% (5% annual) was applied to account for recent spikes in construction costs. The estimate was also based on high-rise office building construction, 2/3 parking deck construction, and 1/3 surface parking. The initial total estimated project cost is shown below.

Initial Total Estimated Project Cost of New DHHS Business Complex on Gold Star Drive Site
Utilizing Build-to-Own or Lease-to-Own Project Delivery Method = $554,413,000

The residual value of the New DHHS Greater Triangle Area Business Complex was estimated based on available commercial sales data in Wake County. The residual value represents the estimated price that the New DHHS Business Complex could be sold for at some time in the future. Assuming an occupancy term of 30 years, the estimated 30-Year Residual Value of the New DHHS Business Complex for the Build-to-Own and Lease-to-Own methods of delivery is $129,735,000.

The Straight-Lease project delivery method involves no State ownership of the project and no Residual Value at the conclusion of the lease.

Lease rates used for the Straight-Lease method of delivery include maintenance, utilities, janitorial, grounds, furniture costs, and parking. The rates also account for the increased costs of high rise office space and parking deck construction required for the preferred Gold Star Drive site. It is anticipated that the first lease payment will be made in 2023 to account for the time required for obtaining State funding approval, issuing an RFP to developers, and for the successful developer designing and constructing the new business complex. Therefore, the first year (2023) lease rates were estimated by escalating 2016 lease rates of comparable leased properties over a seven-year period using a 3% lease rate growth factor. For building the New DHHS Business Complex on the Gold Star Drive site, the initial lease rates for year 2023 were taken as $38.00/USF for high rise office space and parking deck construction and $17.00/USF for warehouse space. Lease payments were calculated based on 904,129 USF of office space and 76,000 USF of warehouse space. A 3% annual lease growth rate was applied to all lease rates for the term of the lease. The estimated total first-year lease cost to the State is $35,648,902.

For both the Build-to-Own and Lease-to-Own options, the annual operating cost for the new complex was estimated at $8,871,626 and the annual budget to account for anticipated replacement of building materials and major equipment over the useful life of the complex was estimated at $1,068,771. Replacement of materials and major equipment included painting every seven years, replacing flooring every 10 years, replacing roofing every 20 years, and replacing major HVAC equipment every 20 to 25 years.

The contract between the State and developer for the Straight-Lease method of delivery will specify that the developer will be responsible for similar replacement of building materials and equipment as listed above and that the lease rates charged to the State shall account for such replacement of building materials and equipment.

Depreciation applied to the Build-to-Own, Lease-to-Own, and Straight-Lease methods include building depreciation over 40 years, furniture depreciation over seven years, parking deck depreciation over 25 years, and parking lot (surface parking) depreciation over eight years.

To comply with new Federal regulations, the Straight-Lease method of delivery will be required to be treated as a capital lease. The total value of the lease agreement will be recorded as a liability on DHHS's balance sheet. As such, the Federal government will not participate in the cost of the monthly lease payment. Rather, the monthly Federal government participation will be for the estimated depreciation and estimated interest expense. For the purposes of our Straight-Lease financial model contained in this report, we estimated depreciation based on the estimated initial project cost minus the estimated 30-year residual value of the property and assumed an estimated building occupancy term of 30 years and an estimated building useful life term of 40 years. The initial project cost was

taken as the total of all lease payments to be made over the 30-year lease agreement term including an annual 3% lease rate of growth. We also estimated interest expense based on an assumed developer finance term of 30 years at a 6.5% interest rate.

New Federal regulations will require that the Straight-Lease method of delivery be considered a capital lease resulting in essentially the same amount of Federal participation for the Build-to-Own, Lease-to-Own, and Straight-Lease methods of delivery. This will be a change from current Federal participation being higher for Straight-Lease compared to Build-to-Own or Lease-to-Own methods of project delivery.

Assumed rates of growth included 3% for operating costs, 2% for utilities, and 3% for lease rates. Based on recent trends in commercial construction, an annual value of 5% (0.42% monthly) was used for escalation costs during construction.

A 30-Year Net Present Value (NPV) calculation was completed for each project delivery method as a means for comparing the financial aspects of each method. NPV represents the funds required today to pay for a total future expense over a given time period based on a selected financial model and interest rate. Therefore, the 30-Year NPV is the amount of money the State would need today to finance the total project cost of the New DHHS Business Complex over the next 30 years. The NPV calculation included the following:

1. Determine annual costs (debt or lease payments plus operating costs for each year)
2. Determine annual revenue (federal revenue/reimbursement for each year)
3. Calculate annual net expense (subtract revenues from costs for each year)
4. Calculate annual NPV (discounting the future annual net expense back to the present year which includes applying a discount formula based on an assumed 3% discount rate)
5. Calculate 30-Year NPV (total of annual NPV for each year over 30 years)

By comparing the 30-Year NPV for each method of project delivery, the best financially viable method can be obtained by identifying the method with the least 30-Year NPV. Considering a 30-year occupancy period at the new complex, the table below summarizes the net costs and Net Present Value (NPV) for providing the New DHHS Business Complex on the Gold Star Drive site for different financing options:

30-YEARR COSTS SUMMARY FOR NEW DHHS OFFICE COMPLEX LOCATED AT GOLD STAR DRIVE SITE				
Project Delivery Method	**Build-to-Own**	**Build-to-Own**	**Lease-to-Own**	**Straight-Lease**
Financing	**State Financed GOB 20 Yr @ 5.75%**	**State Financed SI 20 Yr @ 6.0%**	**Developer Financed 20 Yr @ 6.5%**	**Developer Financed 30 Yr @ 6.5%**
Site Location	**Gold Star Dive**	**Gold Star Dive**	**Gold Star Dive**	**Gold Star Dive**
GOB/SI/Lease Cost	$ 889,146,960	$ 966,730,900	$ 1,006,330,508	$ 1,696,011,332
Operating Cost	$ 424,829,713	$ 424,829,714	$ 424,829,713	N/A
Subtotal Costs	$ 1,313,976,673	$ 1,391,560,614	$ 1,431,160,222	$ 1,696,011,332
Minus Federal Revenue	$ 507,505,134	$ 538,274,644	$ 507,505,134	$ 504,421,557
Net Expense	$ 806,471,540	$ 853,285,970	$ 923,655,088	$ 1,191,589,775
30-Year NPV	**$ 571,760,751**	**$ 606,774,015**	**$ 658,932,988**	**$ 688,973,236**

NOTES:

1. Net Present Values (NPV) based on a 3% discount rate.
2. 30-Year Residual Value for Build-to-Own and Lease-to-Own project delivery methods = $129,735,000.
4. See attached ASSUMPTIONS sheet for assumptions.
6. Moving cost of $2,500,000 was considered an operating cost and not included in the numbers in table above.

Benefits of Relocating

Relocating all the DHHS administrative employees in the Greater Triangle Area to a new business complex at the same location will provide the opportunity to abandon existing space originally designed based on old school design concepts and move to a new business complex designed utilizing modern concepts. Existing DHHS space includes many closed-in offices and conference rooms and narrow halls and corridors that produce an office environment consisting of employees working in their individual silos and closed-off from each other and the outside environment. Current design concepts focus on creating flexible open and flowing work areas and meeting spaces that invite workers to move around freely and mix with each other resulting in greater communication, collaboration, innovation, effectiveness, and efficiencies. Additional benefits of relocating to a new DHHS business complex include:

1. Less travel time and costs – employees currently located in 20 different locations within the Greater Triangle Area will be consolidated to one location to be closer to each other and to other State agencies in downtown Raleigh.

2. Improved productivity – a more functional work environment results in a more productive work force.

3. Reduced energy consumption – modern building systems are considerably more energy efficient and less expensive to operate.

4. More efficient maintenance operations – maintenance staff will be able to master new and consistent building systems instead of keeping various older and different systems in operation.

5. Improved efficiencies in telephone and data systems operations - eliminates multiple systems in multiple buildings.

(4) A schedule for implementation of the relocation plan.

The overall schedule for implementation of the relocation plan is shown below.

State Budget Approval	July, 2017
Design Starts	January, 2018
Construction Starts	January, 2020
Construction Complete	January, 2023
Move-In Complete	January, 2024

The relocation of approximately 4,300 DHHS employees from the Dorothea Dix Campus and other property leased or owned by the State in the Greater Triangle Area to the New DHHS Business Complex will require a phasing plan that will be developed jointly by DHHS divisional representatives and the project design team during the design phase of the project. The phasing plan will need to address many items including, but not limited to, the following:

1. Expiration dates of Lease-Back Agreements with the City of Raleigh for the Dorothea Dix Campus
2. Expiration dates of lease agreements with numerous lessors in the Greater Triangle Area
3. Need for certain DHHS divisions to be located (and moved) together
4. Uninterrupted IT services
5. End of fiscal year impacts
6. Minimizing disruptions to operations
7. Minimizing costs

(5) Identification of any potential obstacles to the relocation plan.

Potential obstacles to the relocation plan include:

1. Uncertainty regarding State funding approval. The current construction market has resulted in about a 25% increase in total project costs over the past 12 to 18 months due primarily to a shortage of qualified subcontractor labor forces. Such fluctuations in the market makes it challenging to predict future construction costs for budgeting purposes. Time is also critical regarding State funding approval. July 2017 is the next biennium State funding approval session. Based on the estimated 24 months for design, 36 months for construction, and 12 months to relocate employees to the New DHHS Business Complex, the completion date for the relocation plan is January, 2024. Considering the expiration date for Dorothea Dix Campus east side lease-back agreement with the City of Raleigh is July 24, 2025, this only

leaves about 18 months of slack to account for any potential issues with State funding approval, design, bidding, and/or construction.

2. Lack of a State-owned site reallocated to DHHS to-date. Reallocation of a State-owned site to DHHS for the new complex has remained an issue to-date. The identified Gold Star Drive site meets our primary needs of public access to the site, DHHS employee access to the site, and proximity of the site to other State agencies in downtown Raleigh. Also, allocation of a site is required to finalize estimated project funding and prior to beginning any design effort.

3. Potential design, bidding, and construction issues. As with any project, and especially for a project requiring approximately 1,000,000 GSF of space, there always exists the potential for unforeseen issues during design, bidding, and construction which could result in schedule delays and budget overruns.

(6) Options for financing the relocation plan developed in conjunction with the State Treasurer and the State Controller.

DHHS worked with the DOA and in conjunction with the Department of State Treasurer and the Office of the State Controller to evaluate options for financing the plan for relocating all DHHS administration personnel and resources on the Dorothea Dix Campus and in other property leased or owned by the State in the Greater Triangle Area to one site available to the State. All financing terms for the Build-to-Own and Lease-to-Own methods of delivery have been assumed to be 20 years and the interest rates used for the General Obligation Bonds and Special Indebtedness (5.75% and 6.00%, respectively) are consistent with those used in the 2016 Debt Affordability Advisory Committee Study. The interest rate used for the Lease-to-Own scenario was assumed at 6.5% for the developer provided financing. The results of the 2016 Debt affordability Advisory Committee Study show that the State has adequate debt capacity to undertake the project under the Build-to-Own and Lease-to-Own financing options specified above. A 30-year term at a 6.5% interest rate were assumed for the developer provided financing for the Straight-Lease option. The Straight-Lease method of delivery will be considered a capital lease and reported as debt on financial statements. Therefore, the Straight-Lease method will impact the debt capacity of the State.

New DHHS Business Complex Located at Gold Star Drive Site in Raleigh, NC
ASSUMPTIONS for Project Delivery Methods Financial Models

Updated 9/30/2016	Project Delivery Methods		
	Build-to-Own	**Lease-to-Own**	**Straight-Lease**
Assumptions			
FTE's (Straight Lease does not include 68 maintenance employees)	4,366	4,366	4,298
Office Space (GSF for Build and Lease to Own & USF for Straight Lease)	972,182	972,182	904,129
Warehouse & Maintenance Space (GSF for Build and Lease to Own & USF for Straight Lease)	95,139	95,139	76,000
Total Space (GSF for Build and Lease to Own and USF for Straight Lease)	1,067,321	1,067,321	980,129
Parking Spaces (Build to Own includes 68 DHHS maintenance staff members)	4,922	4,922	4,854
State Owned Land (State will acquire Garner ConAgra site for Build-to-Own or Lease-to-Own options)	Yes	Yes	Yes
Land Lease Term	N/A	25 years	99 years
Building Lease Term (State becomes owner of property after 20 years for Lease-to-Own)	N/A	20 years	30 years
Term of Financing	20 years	20 years	30 years
Rate of Interest (Building)	5.75% (GO), 6.00% (SI)	6.50% (Developer Rate)	6.50% (Developer Rate)
Rate of Growth (Operating Budget)	3%	3%	N/A
Rate of Growth (Utilities)	2%	2%	2%
Rate of Growth (Lease Rates)	N/A	N/A	3%
Annual Escalation During Construction	5%	5%	N/A
Discount Rate (Used for Present Value Calculation)	3%	3%	3%
State Pays for Maintenance and Utilities	Yes	Yes	Included in lease rates
Annual Operating Cost Paid by State	$8,871,626	$8,871,626	Included in lease rates
High Rise Office Space Lease Rate/USF (Includes maintenance, utilities, janitorial, grounds, & furniture)	N/A	N/A	$38.00
Warehouse Lease Rate/USF (Includes maintenance, utilities, janitorial, grounds, & furniture)	N/A	N/A	$17.00
Developer's Profit	N/A	10% of Constr Costs	Included in lease rates
Ratio of Office Usable Square Foot (USF) to Gross Square Foot (GSF)	N/A	N/A	0.93
Ratio of Warehouse Usable Square Foot (USF) to Gross Square Foot (GSF)	N/A	N/A	0.98
Depreciation - Building	40 years	40 years	40 years
Depreciation - Furniture	7 years	7 years	7 years
Depreciation - Parking Deck	25 years	25 years	25 years
Depreciation - Parking Lot	8 years	8 years	8 years
Paint Every	7 years	7 years	7 years
Replace Flooring Every	10 years	10 years	10 years
Replace Roofing Every	20 years	20 years	20 years
Replace Major HVAC Equipment	20-25 years	20-25 years	20-25 years
Residual Value of Improvements and Land After Year 30	$129,735,000	$129,735,000	N/A